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In the Supreme Court of the United States

OCTOBER TERM, 1979

WILLIAM RUBIN, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether the pledge of stock by petitioner and his co-conspirators as collateral for a loan was an "offer" or "sale" of securities (terms defined by statute to include every disposition or attempt to dispose of an interest in a security for value) and thus was subject to the antifraud provisions of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a).

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OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a–67a) is reported at 609 F.2d 51.

JURISDICTION

The judgment of the court of appeals was entered on September 6, 1979. A petition for rehearing was denied on November 20, 1979. The petition for a writ of certiorari was filed on December 19, 1979, and was granted on April 14, 1980. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTES INVOLVED

Section 2(3) of the Securities Act of 1933, 15 U.S.C. 77b(3), provides in pertinent part:

> The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term * * * "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light

of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

STATEMENT

1. Following a jury trial in the United States District Court for the Southern District of New York, petitioner was convicted on one count of conspiring to violate various federal antifraud statutes, including Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), in violation of 18 U.S.C. 371.[1] Petitioner was sentenced to three years' imprisonment. The court of appeals affirmed (Pet. App. 1a–67a).[2]

The evidence at trial showed that in 1972, following the collapse of the stock brokerage firm in which petitioner was a principal (Tr. 1820), petitioner became vice-president of Tri-State Energy, Inc. ("Tri-State") (Tr. 228,

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[1] The conspiracy count of the indictment alleged that petitioner and his co-defendants conspired to violate 15 U.S.C. 77q(a) (securities fraud), as well as 18 U.S.C. 1014 (fraud in a bank loan application), 18 U.S.C. 1341 (mail fraud), and 18 U.S.C. 1343 (wire fraud). The indictment also contained two substantive counts, charging petitioner with violations of 18 U.S.C. 1014 and 15 U.S.C. 77q(a). The jury acquitted petitioner of the substantive charge under 15 U.S.C. 77q(a), and the government agreed to a dismissal of the charge under 18 U.S.C. 1014 before the jury reached a verdict (Tr. 2761).

[2] Four other defendants, Peter Crosby, Otto Sebold, Leonard James, and C.W. Deaton, were named in the indictment. Upon the government's motion, the proceedings against petitioner were severed before trial. Charges against Deaton were subsequently dropped after he was convicted on six counts of fraud in the United States District Court for the Northern District of Texas and sentenced to 50 years' imprisonment. Sebold and James were convicted of conspiracy, in violation of 18 U.S.C. 371, and securities fraud, in violation of 15 U.S.C. 77q(a). See *United States* v. *James*, 609 F.2d 36 (2d Cir. 1979), cert. denied, No. 79-1115 (Feb. 25, 1980). Co-defendant Crosby was acquitted of all charges.

659, 663-664, 2003). Tri-State, which held itself out as an energy production and exploration company, was in serious financial difficulty at the time. In October 1972, petitioner and two other officers of Tri-State, Leonard James and C.W. Deaton, sought to obtain loans for Tri-State from Bankers Trust Company (Tr. 665, 1368). Initially, the bank rejected the loan request (Tr. 666-667, 1369). Later, however, Tri-State obtained loans totalling $475,000 from the bank, using false documentation, material misrepresentations, and "bogus collateral" (Pet. App. 6a).[3]

2. In obtaining the loans, Tri-State provided the bank with a fraudulent balance sheet that petitioner helped to prepare (Tr. 341, 668-673).[4] The balance sheet listed a $7,500,000 account receivable, based upon a coal sale to a company called Charter Financial, as Tri-State's principal asset (Tr. 344, 349; Gov. Exh. 49, Doc. B-2c). In fact, no such receivable existed; Charter Financial was a shell company without any assets, and the documentation for the account receivable was forged (Pet. App. 6a; Tr. 634-635, 640-647; Gov. Exh. 49, Docs. B-3, B-4, B-5). In addi-

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[3]The original loan of $50,000 was made on October 20, 1972 (J.A. 122a; Gov. Exh. 1). Additional loans were made on November 22, 1972 ($50,000), November 30, 1972 ($100,000), and December 6, 1972 ($275,000) (J.A. 130a, 132a, 134a; Gov. Exhs. 12, 14, 16). These loans were consolidated into a single $475,000 demand note on February 26, 1973 (J.A. 138a; Gov. Exh. 21). See Pet. App. 6a.

Following the initial loan, petitioner gave Raymond Ludwig, the bank branch manager who approved the loan, a $1,500 "gift" (Tr. 676, 1371). Later, he gave Ludwig an additional $2,500 and made two $500 payments to John Keating, another bank officer who also approved the Tri-State loans (Tr. 211, 218, 315-316, 378-379, 1372-1373).

[4]Petitioner, a certified public accountant and law school graduate (Tr. 1774), presented himself to the bank as Tri-State's "financial man" (J.A. 68a; Tr. 598). As the court of appeals observed, petitioner "dress[ed] up Tri-State's financial statement in order to give it the false appearance of a company with a substantial net worth that would generate attractive profits in the future" (Pet. App. 5a).

tion, two uncashed checks totalling $200,000, which were drawn on the personal checking account of a man who previously had been arrested for passing worthless checks, were included in the $264,000 total of "cash on hand" in the balance sheet (Pet. App. 7a; Tr. 668-669, 672, 673). The coal inventories listed in the balance sheet were also overstated (Pet. App. 7a; Tr. 1197).

In addition, the bank received fraudulent projections of future earnings from Tri-State, which petitioner helped to prepare (Tr. 365, 726). Those projections (Gov. Exh. 49, Doc. A-9) were based in substantial part on sham contracts that were supported by forged documents (Pet. App. 8a n.7; Tr. 365-366, 372-373, 667, 722-723, 1109, 1113, 1115, 1174-1175; Gov. Exhs. 49, Doc. B-23; 58) and on an overstatement of coal reserves (Tr. 720).

Further, Tri-State held itself out to the bank as the owner of mineral royalty interests in a producing Kentucky coal mine (Pet. App. 4a-5a, 44a-45a; Tr. 379-381; Gov. Exh. 49, Doc. B-47). In fact, Tri-State leased rather than owned the mine (Tr. 155-167), and while it did briefly conduct a small coal mining operation, it did not follow the usual practice of shipping the mined coal to purchasers (Tr. 156). Instead, Tri-State stockpiled the coal it produced (Tr. 157-158), and then took pictures of the stockpile and freshly painted mining equipment (Tr. 156), presumably for promotional purposes.

3. As the court of appeals stated, "[f]rom the beginning of its relationship with Tri-State, Bankers Trust had made it clear that any loans must be collateralized" (Pet. App. 8a). The bank insisted that Tri-State pledge securities as collateral for its loans (J.A. 14a, 17a, 23a, 31a-34a, 168a-169a; Tr. 246, 254, 305-309; Gov. Exh. 65). The pledged securities were viewed as a source of repayment in the event that Tri-State's projected earnings did not materalize (J.A. 11a; Tr. 239).

In response to the bank's demand, between October 20, 1972 and January 19, 1973, Tri-State pledged stock in six companies.[5] Petitioner, who had substantial business contacts with Bankers Trust prior to his association with Tri-State, served as Tri-State's principal representative with the bank on these and other financial matters (J.A. 14a–15a, 68a–69a; Tr. 247, 540, 598–599).[6]

To effectuate its pledge of securities to the bank, Tri-State executed instruments granting the bank broad powers over the securities. Those instruments gave the bank the right to sell the securities if Tri-State defaulted on its loans (J.A. 124a–127a, 136a, 137a, 140a–143a, 144a–153a, 8a–9a, 21a–23a, 28a–30a, 36a–37a; Gov. Exhs. 7, 8, 19, 20, 28, 29, 37, 38; Tr. 233–234, 281–282, 283–284, 296–299, 313–314). Thus, Tri-State executed in blank "stock powers" that gave the bank the right to "sell, assign, and transfer" the pledged securities and appointed the bank its "attorney to transfer the said stock on the books of [the issuer] with full power of substitution in the premises" (J.A. 124a–127a; Gov. Exhs. 7, 8). Tri-State also executed powers of attorney, applicable to all the stocks pledged, whereby Bankers Trust was "made, constituted and appointed * * * true and lawful attorney [for Tri-State] * * * with power to execute endorsements, assignments or other instruments of conveyance or transfer of certificates

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[5]The stocks were pledged on October 20, 1972 (400,000 shares of American Leisure Corp.); November 10, 1972 (2,000 shares of All States Life Insurance Company); November 22, 1972 (20,000 shares of Marlin Investment Company); December 6, 1972 (100,000 shares of Management Dynamics, Inc.); December 19, 1972 (175,000 shares of General Investment Corporation); and January 19, 1973 (50,000 shares of Satellite Systems Corp.) (J.A. 160a, 168a–169a; Gov. Exhs. 49, Doc. A–7; 65). See Pet. App. 9a n.8. All shares were pledged as collateral for each of the loans. *Ibid.*

[6]Because of the bank's confidence in petitioner, it did less than the customary amount of checking that normally accompanied an extension of credit (J.A. 61a–62a, 71a, 156a; Tr. 430–431, 619–620; Gov. Exh. 48).

of stock or registered securities which it holds or may hold * * *" (J.A. 136a; Gov. Exh. 19). In addition, Tri-State presented corporate resolutions assuring that its agents were empowered to "sell, assign, transfer or dispose of" the stocks that were conveyed to the bank (J.A. 137a, 144a; Gov. Exhs. 20, 30).[7]

From the outset, Bankers Trust insisted that the securities pledged by Tri-State be "good marketable collateral that was not restricted" (J.A. 31a–37a, 13a–14a, 17a, 23a; Tr. 305–315, 245–246, 254, 284). This point was reiterated to petitioner and co-defendant Deaton on a "daily" basis (J.A. 32a; Tr. 307). As described by John Keating (J.A. 33a; Tr. 308):

> The [Tri-State] people were coming into the bank almost on a daily basis, each time they would come in they would be describing various activities of the coal company and the conversations always evolved to the point of the collateral that we were holding and our desires to get New York Stock Exchange collateral.

Keating testified that, when restricted stock is pledged to secure a loan, "it is not marketable in a broad sense" and "the worth of the collateral is substantially reduced, because if you had to sell the stock, you could only do it in dribs and drabs over a long period of time" (J.A. 11a–12a,

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[7]John Keating, the lending officer at Bankers Trust who received the pledged securities in conjunction with these documents, summarized the bank's rights in the collateral as follows (J.A. 22a–23a; Tr. 283): "When you take stock as collateral, there are two ways in which you have the right to sell it; Number 1, you can take stock powers as we did when the American Leisure stock was delivered to the bank. The second way you can do it is to get a blanket form called a power of attorney to endorse securities. This form can be used in lieu of stock powers to cover various amounts of securities * * *." The lending officer added (*ibid.*): "Tri-State Energy * * * is authorizing the bank that they are giving it the right to sell, assign, transfer or dispose of any stocks, bonds, or other securities which the bank may hold as collateral."

94a-95a; Tr. 242-243; see Tr. 1230).[8] Thus, Keating noted (J.A. 13a; Tr. 245):

> obviously the preference of any lending officer was to have unrestricted stock so that if anything went wrong with the loan he would be in a position to sell it right away instead of over an extended period of time.

In response to the bank's continuous requests for high quality marketable securities, Tri-State repeatedly assured the bank that it would supply "good marketable collateral" (J.A. 13a-14a, 17a, 23a, 32a, 33a-34a; Tr. 245-246, 254, 284, 307-309). Contrary to its representations, Tri-State never provided such securities. The securities that it did pledge were "valueless" securities issued by "shell corporations" (Pet. App. 9a; J.A. 85a, 72a-76a, 110a-111a; Tr. 664, 680-687, 820, 892, 1383-1384). Tri-State misled the bank by false representations concerning the value, ownership, and marketability of the securities and took various actions to prevent the bank from determining, through an independent investigation, the true worth of the securities Tri-State had pledged (Pet. App. 4a, 6a, 8a-9a).

4. On October 20, 1972, concurrently with the bank's first ($50,000) loan to Tri-State, Tri-State pledged 400,000 shares of stock issued by American Leisure Corp., a

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[8] Under the Securities Act of 1933, every sale of securities requires registration unless the seller can establish that a statutory exemption is applicable. See Sections 4 and 5 of the Securities Act of 1933, 15 U.S.C. 77d and 77e. One method by which "restricted" securities (securities acquired from the issuer or an affiliate in a non-public transaction) can be sold without registration is by complying with the conditions set forth in Securities and Exchange Commission Rule 144, 17 C.F.R. 230.144, including volume limitations, minimum holding period, manner of sale requirements, and availability of adequate current public information concerning the issuer. Rule 144 also sets forth conditions under which securities held by controlling persons of the issuer can be sold without registration.

"publicly-owned shell" with assets consisting of a pending lawsuit (J.A. 111a, 5a–8a, 110a–112a; Tr. 1384, 222, 228, 233, 1383–1385). This stock had been obtained by Tri-State from Jack Lipsitz, an individual who dealt in what petitioner called "junk stocks" (J.A. 111a; Tr. 1383–1384). Because the restricted nature of the American Leisure stock was apparent on the face of the stock certificate (Gov. Exh. 6),[9] the bank requested that Tri-State replace the stock with marketable collateral (J.A. 14a; Tr. 246). In response, petitioner assured the bank that the restriction was being lifted and that the stock would soon be freely marketable (J.A. 14a, 41a; Tr. 246, 356). In fact, as petitioner well knew (Tr. 1862–1865), that was not the case.[10] Tri-State also agreed to pledge additional marketable securities (J.A. 13a–14a, 31a–33a; Tr. 246, 305–308).

In response to the bank's request for marketable and unrestricted collateral, Tri-State pledged 2,000 shares of stock in All States Life Insurance Company on November 10, 1972 (J.A. 24a–26a, 31a–32a, 65a–66a; Tr. 290–293, 305–306, 580–581; Gov. Exhs. 24–29). This stock, however, was not freely marketable (J.A. 90a–94a, 96a–97a, 110a–111a; Tr. 1212–1216, 1219–1222, 1255–1256, 1383, 1818–1819, 1954). Moreover, contrary to Tri-State's representation that the stock had been acquired for coal rights, it did not own the stock. Instead, the stock had been "rented" for the express purpose of pledging it to the bank as collateral (J.A. 31a–32a, 73a–74a; Tr. 306, 682–683, 1955).

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[9] The certificate stated that the stock was not registered and could not be sold without complying with the registration requirements of the Securities Act of 1933 or obtaining an opinion from American Leisure's counsel that the stock could be sold without registration.

[10] A letter from the president of American Leisure to petitioner (J.A. 166a; Gov. Exh. 49, Doc. B–7), which petitioner used to support his representations to the bank (J.A. 41a; Tr. 355–356), related to the anticipated lifting of restrictions on shares owned only by petitioner personally, not the shares pledged with the bank.

Further, the company had no current assets and the stock was, as petitioner recognized, "without value" (J.A. 72a-74a; Tr. 681-683). To conceal the stock's worthlessness from the bank, petitioner arranged for a broker in the over-the-counter market to place fictitious bid and offer quotations (of $21 and $22 respectively) in the daily "pink sheets" used by the bank to value over-the-counter securities (J.A. 170a-174a, 17a, 76a-77a, 97a-103a, 107a-108a; Gov. Exhs. 146, 147; Tr. 253-254, 687-688, 1269-1278, 1377-1379).[11]

On November 22, 1972, the date on which Tri-State obtained its second loan from the bank, it gave certificates to the bank representing 20,000 shares of Marlin Investment Company (J.A. 28a-29a, 144a-149a; Tr. 296-297, 1095-1096; Gov. Exhs. 36A-D, 37A-C). Although on their face these certificates were registered in the name of Bachelor Investment Company, Tri-State assured the bank that it owned the stock, which it claimed to have received in exchange for coal rights (J.A. 36a; Tr. 313). The stock, however, had been rented by Tri-State from an individual to whom petitioner had stated that the stock was not being

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[11] Petitioner caused the fictitious quotations to appear in the pink sheets for over four months through a friend who operated a stock brokerage firm. The purpose of the sham quotations was to "give a value to" the stock that Tri-State was pledging (J.A. 76a-77a; Tr. 687-688). Petitioner made out a personal check to the brokerage firm so that Tri-State could not be identified with the transaction (*ibid.*). The pink sheet price did not reflect an actual market, as the broker explained, "because this stock was not available, there was no place to buy it" (*ibid.*; see also Tr. 1298). Petitioner admitted full knowledge of the purpose of the fictitious pink sheet quotations. Petitioner's admission was recounted by a federal agent who testified at trial: "Deaton, according to Mr. Rubin, said to him that he wanted the price of All States stock, $21 a share, to appear in the National Quotation Bureau's pink sheets so that the bank or banks could refer to these pink sheets in determining the value or a value for All States stock" (Tr. 1379). Tri-State was attempting at that time to obtain "loans using All States Life Insurance as collateral around the country" (*ibid.*).

used as collateral (J.A. 74a, 112a–115a; Tr. 684, 1394–1399). The bank's subsequent attempts to have the Marlin stock transferred to Tri-State's name were unsuccessful (J.A. 29a, 112a; Tr. 297–298, 1394; Gov. Exhs. 38B, 39).

On December 6, 1972, the date of Tri-State's fourth loan from the bank, Tri-State provided the bank with additional collateral, pledging 100,000 shares of stock in Management Dynamics, Inc., which it represented to be "marketable" (J.A. 26a, 32a–33a; Tr. 293, 307–308).[12] A few days later, however, Management Dynamics discovered it could not account for 900,000 shares, and the Securities and Exchange Commission suspended trading in the stock (J.A. 33a–34a, 82a–83a; Tr. 729–731). Without disclosing this to the bank, petitioner requested that the pledged Management Dynamics shares be released (J.A. 33a–34a, 83a–84a; Tr. 308–309, 730–731). He promised that he would exchange the stock and certain coal rights for New York Stock Exchange collateral by the following Monday (J.A. 33a–34a; Tr. 308–309). Instead, following the bank's release of the stock, petitioner brought the bank 175,000 shares of General Investment Corporation stock (J.A. 27a, 35a, 66a; Tr. 294–295, 310, 581; Gov. Exhs. 32, 33A–Y), which he represented to be "marketable" and unrestricted (Tr. 310), but which in fact was restricted stock (J.A. 168a; Tr. 1480, 1498; Gov. Exh. 57).

By this time Keating had become "quite disturbed" because Tri-State had failed to furnish New York Stock Ex-

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[12] In contrast to the other stocks pledged by Tri-State, there was a market for Management Dynamics stock (Tr. 1401). However, the shares that Tri-State pledged were restricted (Gov. Exh. 196; Tr. 2073). The same day that Tri-State pledged this restricted stock, John Keating prepared a memorandum stating that the bank had advanced $475,000 secured by "marketable securities as lien collateral" (J.A. 50a, 154a; Tr. 396; Gov. Exh. 47).

change collateral, and he conveyed his concern to petitioner (J.A. 35a; Tr. 311). To calm the bank's growing concerns about the adequacy of the collateral, Tri-State pledged 50,000 shares of Satellite Systems, Corp. on January 19, 1973 (J.A. 27a–28a, 35a, 66a; Tr. 295, 311–312, 581; Gov. Exhs. 34, 35). According to Keating, either petitioner or C.W. Deaton, the Secretary-Treasurer of Tri-State, brought the stock into the bank and stated (J.A. 36a; Tr. 312–313):

> Here is a stock, now you don't have to be asking all the time for New York Stock Exchange collateral, because while this isn't New York Stock Exchange collateral, here is collateral for you that is worth $1 million because we are at 50,000 shares, $20 a share.
>
> * * * This stuff is readily marketable, it is not restricted, all the requests that you have should be more than satisfied by this particular piece of stock.

To support this claim, Tri-State gave Keating a clipping from the International Herald Tribune purporting to show that Satellite Systems stock was trading at $20 to $20.50 per share (J.A. 35a–36a, 51a–52a, 78a–80a, 166a–167a; Tr. 311–312, 410–411, 723–724; Gov. Exh. 49, Doc. B–58). As petitioner knew, the clipping was not a report of genuine stock exchange transactions, but was an advertisement that had been placed in the financial section of the paper by one of Tri-State's cohorts to give the false appearance of a market (J.A. 78a–80a; Tr. 723–725, 893).[13] Moreover, contrary to representations made to the bank (Tr. 313), the stock was restricted and was not even owned by Tri-State, but had been "rented" (J.A. 55a–56a, 74a, 80a–81a,

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[13] The advertisement appeared on the same page of the newspaper that reported stock market quotations, and purported to show current bid and offer prices. The bank was completely deceived by this document, believing that it had received one million dollars worth of marketable securities—50,000 shares of stock "traded on a London OTC exchange for approximately $20" (J.A. 165a; Gov. Exh. 49, Doc. A–8).

112a-115a, 117a-118a; Tr. 421-423, 684, 725-726, 1394-1399, 1403-1404), and was conveyed to Tri-State by Peter Crosby, a man who petitioner then knew was a fugitive (J.A. 75a-76a; Tr. 684-686).

At the same time that Tri-State was pledging worthless securities to Bankers Trust to obtain $475,000 in loans, Owen J. Oons, purportedly acting as Tri-State's attorney, was pledging stock in the same companies as collateral to secure bank loans in several other states. Through Oons' efforts, Tri-State obtained an additional $350,000 to $500,000 in loans (J.A. 81a, 107a-108a; Tr. 727, 1379, 1980-1984).

5. By January 1973, although the bank was confident that the collateral was sufficient to cover the loans (J.A. 165a; Gov. Exh. 49, Doc. A-8), it was concerned about Tri-State's deteriorating financial condition and its failure to live up to its projected performance. Keating learned that, despite the $475,000 in loans Tri-State had obtained from Bankers Trust and the company's purported net worth and projected income, the company's checks frequently were being returned for insufficient funds (Gov. Exhs. 41, 43, 49, Docs. B-10a, B-10b; Tr. 358). He also discovered that Tri-State had an unpaid $12,000 overdraft outstanding at Chemical Bank that had been forwarded to that bank's legal department for collection (Tr. 401-402).[14] When Keating confronted petitioner about the overdraft, petitioner denied knowing that a lawsuit was contemplated and stated that he thought that the Chemical Bank matter had been cleared up (Tr. 402).

In January and February 1973, Keating requested the bank's credit department to check with Dun and

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[14] At the time Tri-State opened its account at Bankers Trust, the bank was unaware that Tri-State had an account at Chemical Bank (J.A. 159a; Tr. 401-403; Gov. Exh. 48).

Bradstreet and the International Stock Exchange in London on the various companies whose stocks had been pledged as collateral by Tri-State (J.A. 52a–54a; Tr. 412–414; Gov. Exh. 49, Docs. A–34a, A–38, B–39, B–51, B–35b, A–44, A–25, A–37). At the same time, Keating attempted to insure that the bank had sufficient documentation on the collateral so that it could sell the collateral if necessary (J.A. 52a; Tr. 412).[15]

On February 26, 1973, Bankers Trust consolidated the loans into a single demand note (J.A. 138a–139a; Gov. Exh. 21). On the same day that the demand note was executed, Leonard James, Tri-State's president, advised Keating that Tri-State had coal ready to be shipped but that deliveries had been temporarily halted by a strike (Tr. 426). In fact there was no strike (Tr. 173), and Tri-State could not realistically have hoped to repay the loans because its mine had been shut down.[16] Two days after the demand note was executed, the bank received an inquiry from the Department of Justice asking for information about Tri-State (Tr. 247; Gov. Exh. 49, Doc. B–16) and a subpoena to produce all records relating to the loans (Tr. 434; Gov. Exh. 49, Doc. A–3).

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[15] Despite its growing concerns about Tri-State's financial condition, the bank believed that the collateral it received, particularly the Satellite Systems stock claimed to be worth $1,000,000, would provide complete protection in the case of a default. See J.A. 158a–159a; Gov. Exh. 48: "Additional information has recently caused us to re-evaluate our thinking on this credit. We were recently informed by William Powderly that an unresolved overdraft was outstanding at the Chemical Bank. We had no knowledge that an account at Chemical existed when the account opened. * * * In addition to this unpleasantness, the firm despite our $475M advance is still in a very tight cash position, and we have had occasion to return a number of checks over the past two weeks. * * * As additional support for our loan, we have received an additional $1MM in marketable securities thus bringing our collateral picture to $1.7MM and giving us, what we feel, is adequate protection."

[16] Deaton's brothers, who managed the mine, had left town, and the mine's equipment had been repossessed (Tr. 163–164, 173, 206, 209).

On March 5, 1973, the bank sent a letter to Tri-State demanding repayment in full and explaining that unless payment was tendered in three days the bank would "commence selling the collateral we hold without any further separate notice" (J.A. 60a; Tr. 428; Gov. Exh. 49, Doc. A-1). Tri-State failed to make repayment (J.A. 60a; Tr. 428). Because the collateral pledged by Tri-State was virtually worthless, the bank was able to recover only $2,500 of the $475,000 loan (plus interest and expenses) that it believed had been secured by $1,700,000 of marketable securities (Pet. App. 9a, 11a; J.A. 88a, 165a; Tr. 1129-1130; Gov. Exh. 49, Doc. A-8).[17]

6. Following petitioner's conviction on the conspiracy count of the indictment, the court of appeals affirmed (Pet. App. 34a). In rendering its judgment, the court did not discuss petitioner's contention that Section 17(a) of the Securities Act of 1933 does not extend to fraudulent pledges (Pet. App. 34a). The court apparently relied on its prior decision in *United States* v. *Gentile*, 530 F.2d 461 (2d Cir.), cert. denied, 426 U.S. 936 (1976), which had held that fraudulent pledges are prohibited by Section 17(a).

SUMMARY OF ARGUMENT

A. Petitioner does not deny that he conspired to commit fraud through false representations concerning stock that he and his co-conspirators pledged with Bankers Trust Company. Nor does he deny that the stock certificates were "securities." Rather, he contends that the fraud he conspired to commit is beyond the reach of Section 17(a) of

[17] After signing a confession of judgment against himself for the amount of the unpaid loans, petitioner filed a petition in bankruptcy (Pet. App. 11a; Tr. 1924). Reviewing its collateral situation, the bank restated its understanding that "[a]ll stock except American Leisure Corp. was not supposed to be restricted" (J.A. 168a-169a; Gov. Exh. 65).

the Securities Act of 1933, 15 U.S.C. 77q(a), because his pledge transactions did not satisfy the statutory definition of an "offer" or "sale" of securities. 15 U.S.C. 77b(3). Petitioner argues that he merely conveyed a "security interest that entitle[d] the pledgee to sell the stock on default," and not "ownership" or "title" (Br. 10, 17). In response, we submit that "this is a case in which the meaning of [the] statute may be determined by the admittedly old-fashioned but nonetheless still entirely appropriate 'plain meaning' canon of statutory construction." *United States* v. *Clarke*, No. 78-1693 (Mar. 18, 1980), slip op. 1.

Section 17(a) forbids all fraudulent practices in an "offer" or "sale" of securities. The term "sale" is broadly defined to "include every * * * disposition of * * * [an] interest in a security, for value." The term "offer" is defined in equally broad terms, including "every attempt * * * to dispose of * * * [an] interest in a security, for value." 15 U.S.C. 77b(3). By transferring securities to the bank with stock powers and powers of attorney entitling it to sell those securities for its own benefit upon default, petitioner clearly conveyed an "interest" in the securities. "At the very least," he "attempt[ed] to dispose" of an interest in securities. *United States* v. *Naftalin*, 441 U.S. 768, 773 (1979). And since the bank would not part with its money without a pledge of securities, it is plain that the "value" that the bank gave depended on obtaining an interest in the securities.

In short, considering the plain meaning of the words used by Congress, there is no room to doubt that petitioner's fraud occurred in an "offer" and "sale" of securities. "There is no requirement that title pass" to constitute an offer or sale. *United States* v. *Gentile*, 530 F.2d 461, 466 (2d Cir.), cert. denied, 426 U.S. 936 (1976).

B. When Congress enacted the Securities Act in 1933, it was well established that a pledgee receiving stock as col-

lateral obtained a substantial legal "interest" in the stock for "value." Congress could not have been unaware of this settled doctrine. Under legal principles generally recognized in 1933, a pledgee obtained a "special property" interest in pledged securities, entitling him to possession of the securities and empowering him to sell them without judicial process in the event of a default. The pledgee's legal interest in the collateral was unaffected by the running of the statute of limitations on the underlying debt or by the pledgor's discharge in bankruptcy. The pledgee's legal interest also prevailed over that of third parties claiming prior ownership rights in the securities. It was well established when Congress passed the Securities Act that a pledgee of negotiable securities ordinarily obtained the legal status of a bona fide "holder" or "purchaser" for value. If Congress had intended to exclude the substantial legal interests of a pledgee, it surely would not have written the statutory sale definition to apply to "every" disposition of an "interest" in a security for value.

C. The legislative history of the Securities Act of 1933 also supports the statute's plain meaning. Congress intended the definitions of "sale" and "offer" to be "expansive" ones. *United States* v. *Naftalin*, *supra*, 441 U.S. at 773. In addition, Congress adopted as its model the definition of "sale" prescribed in the Uniform Sale of Securities Act of 1929. The sponsors of the Uniform Act drafted that definition to reach pledge transactions, and the judicial interpretation was in accord. *Cecil B. De Mille Productions, Inc.* v. *Woolery*, 61 F.2d 45 (9th Cir. 1932). Because Congress incorporated this definitional language from the Uniform Sale of Securities Act of 1929, the Court's observation in *Lorillard* v. *Pons*, 434 U.S. 575, 581 (1978), is fully applicable here: "where, as here, Congress adopts a new law incorporating sections of a prior law, Congress

normally can be presumed to have had knowledge of the interpretation given to the incorporated law * * *."

D. The "policy" arguments advanced by petitioner (Br. 20–26) to curtail the express terms of the statute are insubstantial. The federal securities laws were intended to protect "honest business" as well as "investors" and to "help set the economy on the road to recovery" during the depression. *United States* v. *Naftalin*, *supra*, 441 U.S. at 775–776. In furtherance of this purpose, these statutes were designed to "protect * * * the national banking system," and to eliminate securities practices that could "prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system * * *" (15 U.S.C. 78b).

It is irrelevant that petitioner's scheme injured a bank rather than an individual investor. As this Court held in *United States* v. *Naftalin*, *supra*, 441 U.S. at 776, the Securities Act of 1933 was designed to protect "financial intermediaries" as well as investors. It would also be irrelevant if the victim of petitioner's fraud had assumed only a "commercial risk" and not an "investment risk." Nothing on the face of the statute suggests that its coverage should be narrowed by reference to "undefined categor[ies]" such as investment risk and commercial risk. See *United States* v. *Culbert*, 435 U.S. 371, 380 (1978). Congress has specified the context in which Section 17(a) applies—"every" transaction in which an "interest" in a security is conveyed for "value." The "investment risk"/"commercial risk" dichotomy that petitioner suggests offers no assistance in applying that statutory standard. In any event, the dichotomy that petitioner relies on is an artificial one. Banks parting with their money on the express understanding that marketable securities will be pledged to collateralize a loan assume risks that are comparable to those of investors.

Petitioner's contention that fraudulent pledges are of primary concern to the states, and not the federal government (Br. 25–26), is refuted by the legislative history of the Securities Acts Amendments of 1975, Pub. L. No. 94–29, 89 Stat. 97. The legislative history of those amendments shows that fraudulent pledges are a primary means by which participants in organized crime convert otherwise unmarketable securities into cash, often for reinvestment into other organized criminal activities. These transactions, involving worthless, counterfeit and stolen securities, have caused serious financial injury to many federally insured banking institutions. Fraudulent pledges are carried on by organized crime on a nationwide and often on an international basis. Local authorities are powerless to prevent fraudulent practices occurring on such a scale.

ARGUMENT

SECTION 17(a) OF THE SECURITIES ACT OF 1933 PROHIBITS FRAUD IN THE PLEDGE OF SECURITIES

The jury found petitioner guilty of conspiracy to violate various federal antifraud statutes, including Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), a provision "'designed to protect not only the investing public but at the same time to protect honest corporate business.'" *United States* v. *Naftalin*, 441 U.S. 768, 776 (1979). In this Court, petitioner does not dispute that he conspired to defraud Bankers Trust Company through false representations concerning the value, marketability and ownership of the collateral that was pledged with the bank. Nor does he deny that the stocks that he pledged were "securities" within the meaning of Section 2(1) of the Securities Act of 1933, 15 U.S.C. 77b(1), or that the stocks were required

by the bank as a prerequisite for extending almost one-half million dollars in loans. Rather, he contends (Br. 12–20) that Section 17(a) does not prohibit fraud in the pledge of securities, and, therefore, his conduct could not have violated the statute. The limiting construction that petitioner suggests, however, is plainly inconsistent with the literal terms of the statute and "would create a loophole in the statute that Congress simply did not intend to create." *United States* v. *Naftalin*, *supra*, 441 U.S. at 777.

A. Fraud in the Pledge of Securities as Collateral for a Loan Is Forbidden by the Plain Language Used by Congress in the Securities Act of 1933

1. As this Court repeatedly has emphasized in construing the federal securities laws, "'[t]he starting point in every case involving construction of a statute is the language itself.'" *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 558 (1979), quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring). See also *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, No. 77–1645 (Nov. 13, 1979), slip op. 4; *Aaron* v. *SEC*, No. 79–66 (June 2, 1980), slip op. 9; *United States* v. *Clarke*, No. 78–1693 (Mar. 18, 1980), slip op. 1. Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), broadly forbids any person, "in the offer or sale of any securities," to engage in any fraudulent practice.[18] Section 17(a)(1) forbids any person to employ any device, scheme or artifice to defraud in an offer or sale of securities. Section 17(a)(2) forbids any person to obtain money or property by means of any untrue statement or

[18]The indictment in this case charged that petitioner conspired to commit fraudulent practices "in the offer and sale" of securities, and that the conspiracy was carried out through the pledges made with Bankers Trust Company. Indictment, Count 1, ¶ 18.

omission to state a material fact needed to avoid deception in an offer or sale of securities. And Section 17(a)(3) forbids any person to engage in any practice in an offer or sale of securities that operates or would operate as a fraud or deceit on the purchaser.[19]

The statutory terms "offer" and "sale" are, in turn, defined in comprehensive terms. Under Section 2(3) of the Act, 15 U.S.C. 77b(3), the term "sale" is expressly defined to "include every contract of sale or disposition of a security *or interest in a security*, for value" (emphasis supplied). The term "offer" is defined in equally broad terms. Under Section 2(3), an "offer" is defined to include "every attempt * * * to dispose of * * * a security *or interest in a security*, for value" (emphasis supplied).[20] Thus, according to the plain meaning of the terms used by Congress, the statute extends to every disposition of an "interest" in a security for value and every "attempt" to dispose of an "interest" in a security for value. As this Court noted in *United States* v. *Naftalin*, *supra*, 441 U.S. at 773, these are "expansive" terms, which Congress "expressly intended to define broadly * * *." See also *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 467 n.8 (1969); I L. Loss, *Securities Regulation* 512 & nn.162–163 (2d ed. 1961).

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[19] As this Court noted in *United States* v. *Naftalin*, *supra*, 441 U.S. at 773–774, "while impact upon a purchaser may be relevant to prosecutions brought under § 17(a)(3), it is not required for those brought under § 17(a)(1). * * * Each * * * prohibition is meant to cover additional kinds of illegalities * * *."

[20] As originally enacted, the terms "sale" and "offer to sell" were included in a single definitional sentence. See 48 Stat. 74. In 1954, Congress amended the Act to provide separate definitions of "offer" and "sale." To preserve existing law, Section 17(a) was amended to include the term "offer." See 68 Stat. 683, 686; S. Rep. No. 1036, 83d Cong., 2d Sess. 4 (1954).

Giving the words used by Congress "their ordinary, contemporary, common meaning" (*Perrin* v. *United States*, No. 78–959 (Nov. 27, 1979), slip op. 5), it is clear that petitioner and his co-conspirators offered and sold securities. Petitioner concedes (Br. 17) that he conveyed to the bank a "security interest that entitle[d] the pledgee to sell the stock on default." That "interest" was formalized by the stock powers and powers of attorney that petitioner and his co-conspirators delivered to the bank in conjunction with the securities, which gave the bank the legal right to sell or assign the securities. The bank also obtained sole possession of the securities so that it could enforce its interest through prompt liquidation. Of course, the bank gave value for its interest in the securities when it extended $475,000 in loans. That money was furnished to petitioner and his co-conspirators on the express condition that they provide the bank with "good marketable securities."[21] In sum, petitioner and his co-conspirators "sold" securities because they disposed of an "interest" in the securities for value.[22] "At the very least," they offered securities because they "attempt[ed] to dispose" of an interest in the securities for value. *United States* v. *Naftalin*, *supra*, 441 U.S. at 773. Thus, although petitioner argues that the statute should be narrowed to exclude

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[21] As the court of appeals emphasized: "From the beginning of its relationship with Tri-State, Bankers Trust had made it clear that any loans must be collateralized" (Pet. App. 8a).

[22] Indeed, the pledges, coupled with stock powers and powers of attorney authorizing the bank to sell the securities, constituted a "contract" to sell under specified circumstances (default), and thus fell within the statutory definition of "sale" for an independent reason. The fact that the sale depended on the occurrence of a future contingency is irrelevant, since many conventional securities contracts (including stop loss orders, limit orders, and options) are contingent in nature. See *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 750–751 (1975) (options); see also *Kerbs* v. *Fall River Industries, Inc.*, 502 F.2d 731, 738–739 (10th Cir. 1974).

fraudulent pledges, "[n]othing on the face of the statute supports this reading of it." *Id.* at 772.

2. Petitioner argues that the word "sale" cannot apply to the transfer of a "security interest" for value because the word "sale" implies "transfer of title or ownership* * *" (Br. 10). In making this argument, petitioner relies on dictionary definitions of the term "sale" (*id.* at 16). However, "[t]he short answer is that Congress did not write the statute that way." *United States* v. *Naftalin*, *supra*, 441 U.S. at 773. Congress prescribed its own definition of the word "sale," which expressly includes "every" transfer of an "interest" in a security for value, as well as transfers of title. See *United States* v. *Gentile*, 530 F.2d 461, 466 (2d Cir.), cert. denied, 426 U.S. 936 (1976):

> The term "sale" is defined in the Securities Act of 1933, § 2(3), 15 U.S.C. § 77b(3) to include "every contract of sale or disposition of a security or interest in a security, for value." There is no requirement that title pass to constitute a "sale" within the meaning of the statute. Indeed, to read "sale" so restrictively would render superfluous the latter two disjunctive phrases in the statutory definition. Since Gentile obviously obtained value in the form of bank loans for his pledge of stock, his actions fall within the strict construction that we apply to criminal statutes.

See also *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 733 n.5; *Kerbs* v. *Fall River Industries, Inc.*, *supra*, 502 F.2d at 739; *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1028–1029 (6th Cir. 1979). As the Seventh Circuit correctly observed in *Dasho* v. *Susquehanna Corp.*, 380 F.2d 262, 266 (7th Cir.), cert. denied, 389 U.S. 977 (1967) (discussing the definition of "sale" in the Securities Exchange Act of 1934), "[t]his broad language indicates an intention by Congress that the words 'purchase' and 'sale' are not limited to transactions ordinarily governed by the commercial law of sales. The

purpose is evidently to make control of securities transactions reasonably complete and effective to accomplish the purposes of the legislation."

By ignoring the fact that Congress has prohibited fraud in the process of disposing of an "interest" in securities, as well as fraud in the process of transferring ownership, petitioner's argument clashes with the basic rule that "[i]n construing a statute we are obliged to give effect, if possible, to every word Congress used." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979). Petitioner's interpretation violates "the elementary canon of construction that a statute should be interpreted so as not to render one part inoperative." *Colautti* v. *Franklin*, 439 U.S. 379, 392 (1979). Such an interpretation is particularly inappropriate under an antifraud statute that was intentionally drafted in comprehensive terms to eliminate fraud in all aspects of securities transactions.[23] See *United States* v. *Naftalin*, *supra*, 441 U.S. at 774: "There is * * * 'no warrant for narrowing alternative provisions which the legislature has adopted with the purpose of affording added safeguards.'"[24]

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[23] The statutory definition embraces three categories of "sale" transactions—contracts of sale, dispositions of securities for value, and dispositions of interests in securities for value. The broad nature of the definition is shown by Congress' use of the word "include," which demonstrates that the transactions specifically enumerated are not exclusive. See generally *SEC* v. *National Securities, Inc.*, *supra*, 393 U.S. at 467 n.8. See also I L. Loss, *Securities Regulation*, *supra*, at 512–513 & n.162.

[24] Petitioner's suggestion (Br. 17) that a "security interest" is of lesser economic significance than other interests is also refuted by the plain meaning of the statute. The statute is not limited to particular economic interests. It extends to "every" interest, and there is nothing unreasonable about applying the statute at face value. See *United States* v. *Rutherford*, 442 U.S. 544, 555 (1979): "Only when a literal construction of a statute yields results so manifestly unreasonable that they could not fairly be attributed to congressional design will an exception to statutory language be judicially implied." See also *TVA* v. *Hill*, 437 U.S. 153, 187–188 & n.33, 194–195 (1978).

Nor can petitioner find support for his restrictive reading of the Act in the absence of the word "pledge" in the definition. The statute employs generic language—embracing "every" interest in a security—which covers a pledgee's legal interest and other interests as well. Congress did not define the term "sale" by attempting to prescribe an exhaustive list of transactions intended to be covered. Thus, the absence of the word pledge "provides no basis for concluding that Congress intended to exclude [that type of transaction] from the Act's coverage." *Tcherepnin* v. *Knight*, 389 U.S. 332, 344 (1967). This Court and the lower federal courts repeatedly have recognized that a wide variety of transactions not mentioned by name—including mergers,[25] issuance of stock,[26] short sales,[27] puts, calls and options,[28] and exchanges of shares[29]—are encompassed by the generic "sale" definitions used in the federal securities laws.

In sum, the statutory definitions of "sale" and "offer," broadly embracing every disposition of an interest in a security for value and every attempt to dispose of an inter-

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[25]*SEC* v. *National Securities, Inc.*, *supra*, 393 U.S. at 465–468; *Smallwood* v. *Pearl Brewing Co.*, 489 F.2d 579, 591 (5th Cir.), cert. denied, 419 U.S. 873 (1974); *Vine* v. *Beneficial Finance Co.*, 374 F.2d 627, 634 (2d Cir.), cert. denied, 389 U.S. 970 (1967); *Dasho* v. *Susquehanna Corp.*, *supra*, 380 F.2d at 266–267.

[26]*Schoenbaum* v. *Firstbrook*, 405 F.2d 215, 219–220 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969); *Hooper* v. *Mountain States Securities Corp.*, 282 F.2d 195, 202–203 (5th Cir. 1960), cert. denied, 365 U.S. 814 (1961).

[27]*United States* v. *Naftalin*, *supra*, 441 U.S. at 776.

[28]*Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 750–751.

[29]*Bryan* v. *Brock & Blevins Co.*, 490 F.2d 563, 568 (5th Cir.), cert. denied, 419 U.S. 844 (1974); *Swanson* v. *American Consumer Industries, Inc.*, 415 F.2d 1326, 1330 (7th Cir. 1969); *Knauff* v. *Utah Construction & Mining Co.*, 408 F.2d 958, 961 (10th Cir.), cert. denied, 396 U.S. 831 (1969).

est for value, include the security interest conveyed to the bank by petitioner. There is no warrant for implying exceptions to the broad language prescribed by Congress to eliminate fraud in all phases of securities transactions. See *United States* v. *Naftalin*, *supra*, 441 U.S. at 772, 774; *United States* v. *Culbert*, 435 U.S. 371, 373–374, 380 (1978).[30]

B. It Was Well Established in 1933 That a Pledgee Receiving Securities as Collateral for a Loan Obtained an "Interest" in the Securities for "Value"

While the "plain meaning" of the definition of the term sale in the Securities Act is "so unambiguous as to suggest that 'further inquiry may be unnecessary'" (*Aaron* v. *SEC*, *supra*, slip op. 9, quoting *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 201 (1976)), an examination of legal principles established in 1933 fortifies the conclusion that petitioner's securities transactions fall within the statutory definition. That examination shows general rec-

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[30] While petitioner relies on the sale definition in the Securities Exchange Act of 1934 (Br. 14), the language used in that definition is not the same as that used to define the words "offer" and "sale" in the Securities Act of 1933. See, *e.g.*, *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 733 n.5; see also *id.* at 750–751 n.13; note 36, *infra*. In particular, the sale definition in the Securities Act of 1933 extends to every disposition of an "interest" in a security for value. In contrast, the definition of sale in the Securities Exchange Act of 1934 includes "any contract to sell or otherwise dispose of" a security. 15 U.S.C. 78c(a)(14). The Securities Exchange Act definition does not expressly refer to the transfer of an "interest" in securities. For that reason, even if pledges were not viewed as sales under the Securities Exchange Act, that would not be dispositive of the question presented in this case—whether pledges are offers or sales under the Securities Act. Nonetheless, those lower court decisions holding that a pledge of securities is a sale under the Securities Exchange Act provide *a fortiori* support for application of the Securities Act to such transactions, in view of the more expansive language in the Securities Act definition. See note 45, *infra*.

ognition at the time when the Securities Act was enacted that a pledgee receiving securities as collateral for a loan obtained a substantial "interest" in the securities for "value."

1. By 1933, it was generally recognized that a pledgee receiving securities as collateral for a loan obtained a substantial legal "interest" in the securities.[31] That interest was described as a "special property" in the securities. See *Jones on Collateral Securities* 4–6, 12, 190–191 (1912); J. Story, *Commentaries on the Law of Bailments* 241 (1863); *Yeatman* v. *Savings Institution*, 95 U.S. 764, 766 (1877).

The "special property" of the pledgee entailed a bundle of specific legal rights and interests. In the case of collateral securities, the pledgee obtained "the interest of the pledgor, subject to the latter's power to redeem" if the loan was repaid. *Restatement of the Law of Security* § 2, comment at 14 (1941). The pledgee could compel endorsement of collateral securities *(ibid.)*; retain any dividends or profits stemming from the pledged securities as additional collateral (*id.* at § 3); assign the pledged securities and secured debt (*id.* at § 29); and (unlike a lien holder) sell the collateral following default without judicial foreclosure (*id.* at § 48). The pledgee's legal rights in collateral securities were unaffected by either the running of the

[31] In 1933, the word "interest" was recognized as being "[t]he most general term that can be employed to denote a property in lands or chattels. * * * More particularly it means a right to have the advantage accruing from anything; any right in the nature of property, but less than title * * *." *Black's Law Dictionary* 646 (2d ed. 1910). See also *The Oxford English Dictionary* 393 (1933), defining the word "interest" as a "legal concern in a thing; esp. right or title to property, or to some of the uses or benefits pertaining to property." Accord, *Webster's New International Dictionary of the English Language* 1125 (1930), defining "interest" as a "right, title, share, or participation in a thing * * * specif., participation in advantage, profit, and responsibility * * *." Thus, "interest" includes ownership or title, but is not so limited.

statute of limitations on the claim underlying the pledge or a discharge of the claim in bankruptcy (*id.* at § 47).

2. It was also well established prior to 1933 that the pledgee's "special property" interest in negotiable securities obtained as collateral without notice of adverse claims was superior to the interest of third parties asserting ownership of the securities—*i.e.*, the pledgee received "a legal interest sufficient to invoke the rule protecting bona fide purchasers." 49 C.J. *Pledges* § 64 (1930). The decisions of this Court acknowledged that rule. See, *e.g.*, *Railroad Co.* v. *National Bank*, 102 U.S. 14, 25–26 (1880):

> [I]t may be regarded as settled in commercial jurisprudence * * * that where negotiable paper * * * is transferred, by indorsement, as collateral security for a debt created * * * at the time of transfer * * * the holder who takes the transferred paper * * * without notice * * * of any defence thereto, is held to have received it in due course of business, and * * * becomes a holder for value * * *.

Accord, *Restatement of the Law of Security*, *supra*, at § 35(b); see also *id.* at 109 (illustration). This concept was adopted in the earliest commercial law codifications in this country. For example, under the Uniform Negotiable Instruments Law, approved by the National Conference of Commissioners on Uniform State Laws in 1896 and subsequently adopted in every state in the Union prior to 1933 (see National Conference of Commissioners on Uniform State Laws, *Handbook and Proceedings* 504, 517 (1933) (hereinafter *Handbook and Proceedings*)), a pledgee receiving negotiable instruments was deemed a holder for value. See Uniform Negotiable Instruments Act §§ 25, 27, 52, 57 (reproduced in 5 Uniform Laws Annotated (1943)). Similarly, under the Uniform Stock Transfer Act, which was approved in 1907 and adopted in 23 states prior to 1933 (see *Handbook and Proceedings*,

supra, at 503, 517), a "pledgee" was deemed a "purchaser" for "value" if he received stock collateral for a contemporaneous or antecedent debt. See Uniform Stock Transfer Act § 22 (reproduced in 6 Uniform Laws Annotated (1922)).[32] Summarizing this body of law in 1914, the Seventh Circuit observed in *National City Bank of Chicago* v. *Wagner*, 216 F. 473, 481–482 (7th Cir. 1914):

> By the great weight of authority at common law, both in England and the United States, and now by the Uniform Negotiable Instruments Act, in force in 46 jurisdictions, one who takes commercial paper as collateral security for a preexisting debt is deemed to have given value. * * * As further evidencing the mercantile view of the character of documents such as stock certificates, bills of lading, and warehouse receipts, it may be noted that under the provisions of the Uniform Warehouse Receipts Act, in force in 30 jurisdictions, * * * and the [Uniform] Stock [Transfer] Act, in force in 9 jurisdictions, purchaser for value is defined as including one taking such documents as collateral for a pre-existing debt.

Not only were the foregoing principles of commercial law well established in 1933, when the Securities Act was passed by Congress, but they continue to be recognized

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[32] Likewise, under the Uniform Warehouse Receipts Act, which was approved in 1906 and adopted in 44 states by 1933 (*Handbook and Proceedings*, *supra*, at 504, 518), a "pledgee" who extended credit secured by warehouse receipts was deemed a "purchaser" for value. See Uniform Warehouse Receipts Act §§ 37–41, 58 (reproduced in 3 Uniform Laws Annotated (1959)). The same rule was expressed in § 1 of the Uniform Conditional Sales Act, approved in 1918 and adopted in 9 states by 1933 (*Handbook and Proceedings*, *supra*, at 503, 515); in § 53 of the Uniform Bills of Lading Act, approved in 1909 and adopted in 29 states by 1933 (*Handbook and Proceedings*, *supra*, at 503, 515); and in § 76 of the Uniform Sales Act, approved in 1906 and adopted in 32 states by 1933 (*Handbook and Proceedings*, *supra*, at 504, 517) (reproduced in 2 Uniform Laws Annotated (1922), 4 Uniform Laws Annotated (1922), and 1A Uniform Laws Annotated (1950), respectively).

today in every state (except Louisiana) under the provisions of the Uniform Commercial Code. The Code, which was in effect in New York at the time of petitioner's pledges, provides expressly that a "pledgee" is a "purchaser" and that a pledgee gives "value" when he extends credit or receives collateral for a pre-existing debt. See N.Y. U.C.C. (62½–Pt. 1) § 1–201(32), (33), (44) (McKinney 1964). See also *id.* at §§ 8–301, 8–302, 8–308 (Pt. 3) (bona fide purchaser rule protects securities purchasers who obtain securities for value without notice of adverse claims).[33] A bank pledgee may resell the collateral in any commercially reasonable manner. See *id.* at § 9–504 (Pt. 3).

In sum, looking at the "ordinary meaning" of the terms used by Congress "at the time Congress enacted the statute" (*Perrin* v. *United States*, *supra*, slip op. 5), it is clear that petitioner's pledge of securities was a disposition of an "interest" in those securities for "value." In other words, at the time when Congress drafted the definition of "sale" in the Securities Act of 1933, which expressly includes "every" disposition of an interest in a security for value, it was well established that a pledge was precisely such a disposition.[34]

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[33] See E. Peters, *A Negotiable Instruments Primer* 35 (2d ed. 1974): "A bank which has taken a pledge interest in deposited instruments as security for a loan is a purchaser for value to the extent of the pledgor's outstanding indebtedness * * *." For a recent application of New York's "bona fide purchaser" rule to a bank pledgee obtaining collateral securities, see *Gutekunst* v. *Continental Ins. Co.*, 486 F.2d 194 (2d Cir. 1973).

[34] See *Lorillard* v. *Pons*, 434 U.S. 575, 583 (1978), quoting *Standard Oil Co.* v. *United States*, 221 U.S. 1, 59 (1911): "'where words are employed in a statute which had at the time a well-known meaning at common law or in the law of this country they are presumed to have been used in that sense unless the context compels to the contrary.'" See also *Cannon* v. *University of Chicago*, 441 U.S. 677, 696–697 (1979).

C. The Legislative History of the Securities Act of 1933 Supports the View That a Pledge of Securities is a Disposition of an Interest in Securities for Value and Thus Falls Within the Statutory Definition of "Sale"

Petitioner contends (Br. 15) that the legislative history of the Securities Act of 1933 does not address the question whether a pledge of securities falls within the Act's generic definition of sale. Even if that were the case, the silence of the legislative history would not alter the plain meaning of the terms used by Congress. As this Court recently noted in *Harrison* v. *PPG Industries, Inc.*, No. 78–1918 (May 27, 1980), slip op. 13:

> [I]t would be a strange canon of statutory construction that would require Congress to state in committee reports or elsewhere in its deliberations that which is obvious on the face of a statute. In ascertaining the meaning of a statute, a court cannot, in the manner of Sherlock Holmes, pursue the theory of the dog that did not bark.

In short, "[p]etitioner's argument would permit an omission in the legislative history to nullify the plain meaning of a statute." *Standefer* v. *United States*, No. 79–383 (June 9, 1980), slip op. 9–10 n.12.[35]

In fact, however, the legislative history is not silent. It provides important indicia of congressional intent that further support the view that a pledge of securities, which conveys legal rights in the securities for value, is a "sale" transaction within the statutory definition. The legislative history shows that Congress intended its definition of sale

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[35] Even a statement in the legislative history suggestive of a limited statutory purpose would not override express statutory language phrased in broad generic terms. See *Diamond* v. *Chakrabarty*, No. 79–136 (June 16, 1980), slip op. 12: "This Court frequently has observed that a statute is not to be confined to the 'particular application[s] . . . contemplated by the legislators.'"

to be a broad one. *United States* v. *Naftalin*, *supra*, 441 U.S. at 773; H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933). The legislative history also shows that Congress intended to pattern the definition of sale in the Securities Act of 1933 on an existing statutory precedent—the definition of "sale" contained in the Uniform Sale of Securities Act of 1929. As we demonstrate below, the Uniform Act included pledges within its definition of "sale." This review of the legislative history provides additional evidence that petitioner's narrow interpretation is at odds with the statutory design.[36]

1. Prior to the enactment of the Securities Act of 1933, 47 state legislatures had enacted their own securities laws, prescribing antifraud, registration and licensing provisions to regulate securities transactions. See S. Rep. No. 47, 73d Cong., 1st Sess. 2 (1933); *Federal Securities Act: Hearings on H.R. 4314 Before the House Comm. on In-*

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[36] Instead of analyzing the legislative history, petitioner relies (Br. 14, 15, 25) on a subsequent legislative event—the enactment of Section 2(a)(23) of the Public Utility Holding Company Act, 15 U.S.C. 79b(a)(23), in 1935. Section 2(a)(23) provides:

> "Sale" or "sell" includes any sale, disposition by lease, exchange or pledge, or other disposition.

This subsequent enactment does not affect the scope of the earlier statute, which includes in its generic definition of "sale" all dispositions of an "interest" in securities, including pledges. There is "no basis for reading into [Congress' later] actions an intent to modify the plain meaning of the words" used in the 1933 Act. *Diamond* v. *Chakrabarty*, *supra*, slip op. 10. As this Court emphasized in *United States* v. *Naftalin*, *supra*, 441 U.S. at 777 n.8, "subsequent enactments do not serve to restrict the original scope of § 17(a)." See also *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 197–200 (1963). Moreover, even if Section 2(a)(23) were relevant to the issue in this case, that provision clearly supports the government's position, not petitioner's position. The language used by Congress leaves no room to doubt that Congress believed that a "pledge" is a *type* of "disposition" of a security. And since *every* "disposition" of a security for value is covered by the definition of "sale" contained in the Securities Act of 1933, it follows plainly that the Securities Act's definition includes "pledges."

terstate and Foreign Commerce, 73d Cong., 1st Sess. 10 (1933) (hereinafter "*House Hearings*"); I L. Loss, *Securities Regulation*, *supra*, at 30–89. In light of the diversity of state statutes in this field, the National Conference of Commissioners on Uniform State Laws initiated a seven-year project in 1922 to draft a comprehensive "blue sky" law. See *Handbook and Proceedings*, *supra*, at 171 (1929). That project is of particular importance here because the culmination of the Commissioners' efforts—the Uniform Sale of Securities Act approved by the Conference of Commissioners and the American Bar Association in 1929—contained a definition of the term "sale" that Congress shortly thereafter incorporated almost verbatim in the Securities Act of 1933. See *House Hearings*, *supra*, at 13.

The first and second tentative drafts of the Uniform Sale of Securities Act defined the terms "sale" and "sell" to

> include the issuance of securities, an agreement whereby a person transfers or agrees to transfer an interest in securities, and an exchange, pledge, hypothecation, or any transfer in trust or otherwise by way of mortgage.

Handbook and Proceedings, *supra*, at 231 (First Draft) (1923); *id.* at 523 (Second Draft) (1924). The Commissioners apparently modeled this definition on the almost identical sale definition found in the Massachusetts blue sky law at that time. See 1921 Mass. Acts ch. 110 A, § 2(d), at 623. The same formulation was also adopted in other states. See, *e.g.*, California Corporate Securities Act, 1925 Cal. Stat. ch. 447, § 2(9), at 964–965; South Dakota Securities Law, 1927 S.D. Sess. Laws ch. 206, § 2(2), at 240.

Beginning with the third draft of the Uniform Sale of Securities Act prepared in 1927, this attempt to set forth a

particularized listing of specific types of sale transactions, such as issuance and pledges of securities, was abandoned in favor of a streamlined, generic definition. As finally adopted in 1929, the term "sale" was defined to "include every disposition, or attempt to dispose of a security or interest in a security for value." See *Handbook and Proceedings, supra,* at 174 (Fourth and Final Draft) (1929); *id.* at 578 (Third Draft) (1927).[37] At about this time, expansive sale definitions utilizing the "every disposition * * * of [an] interest in a security" phraseology began to appear in state blue sky laws. See, *e.g.*, Indiana Securities Law, 1925 Ind. Acts ch. 31, § 3(3), at 85; Illinois Securities Law, Ill. Ann. Stat. ch. 32, § 255, at 447 (Callaghan Supp. 1925–1931); Oregon Securities Law, 1929 Or. Laws ch. 461, § 6838(f), at 709–710; California Corporate Securities Act, 1929 Cal. Stat. ch. 707, § 2(a)(8), at 1252.

By including "every" disposition of an "interest in a security," these state laws and the Uniform Act embraced the full range of ownership interests and non-ownership interests in securities. The generic definition eliminated the need for a particularized listing of covered transactions. A listing of transactions would have been an invitation to evasion of the statutory purpose—to regulate the disposition for value of all legally recognized "interests" in securities.

Just one year before Congress enacted the Securities Act of 1933, the United States Court of Appeals for the Ninth Circuit considered the question whether a pledge of securities was a "sale" under the California Corporate Securities Act. *Cecil B. De Mille Productions, Inc.* v.

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[37] The Uniform Act further provided that: " 'Sale' or 'Sell' shall also include a contract to sell, an exchange, an attempt to sell, * * * a solicitation of a sale, * * * or an offer to sell * * *." *Handbook and Proceedings, supra,* at 174 (Fourth and Final Draft) (1929); *id.* at 578 (Third Draft) (1927).

Woolery, 61 F.2d 45 (9th Cir. 1932). As previously noted, California had followed the evolution of the Uniform Sale of Securities Act, first specifically defining the term "sale" to include pledges, and later adopting a generic definition extending to every disposition of an "interest" in a security for value. The Ninth Circuit stated in *Woolery* that the argument that a pledge was not a "sale" under the generic definition was "extremely specious," explaining (*id.* at 50; emphasis in original):

> As we have seen, the act defines "sale" as "every disposition, or attempt to dispose, of a security or *interest in a security* for value." Counsel * * * assert that "a pledgee has merely a special property or *interest in the thing pledged*." Therefore, it is obvious that, when the [pledgor] pledged these contracts for its debt to the [pledgee], the former "disposed" or attempted to dispose, of an "interest in a security."

2. The legislative history of the Securities Act of 1933 shows that Congress intended to incorporate the broad generic concept of sale evolved under the Uniform Sale of Securities Act of 1929. The draftsmen of the Securities Act borrowed heavily from state blue sky laws and, in particular, from the Uniform Sale of Securities Act of 1929. See *Aaron* v. *SEC*, *supra*, slip op. 8–9 (Blackmun, J., concurring and dissenting). As Huston Thompson, a principal draftsman of the federal legislation, observed:

> We had the Uniform Sale of Securities Act [before us]. It was drafted by the Commissioners of 38 States, I believe, in connection with the American Bar Association. We have followed the language in this bill wherever we could, and somewhat of its policy. That act, I may say, was worked out by lawyers and commissioners from the various States, and was then taken up before the American Bar Association. On two occasions the association has adopted and approved of it. So you see that we have a number of

> precedents here that have had approval by high authority.

House Hearings, supra, at 11. See also *Securities Act: Hearings on S. 875 Before the Senate Comm. on Banking and Currency,* 73d Cong., 1st Sess. 71 (1933).

The influence of the Uniform Act was nowhere more apparent than in the definitional provisions of the Securities Act of 1933. As Mr. Thompson stated, "[w]ith regard to the subject of definitions, I may say that we have attempted to follow the Uniform Sale of Securities Act * * *." *House Hearings, supra,* at 13. In fact, the definition of sale that Congress incorporated in the Securities Act of 1933 is virtually identical to the phraseology used in the Uniform Act. Compare Section 2(3) of the Securities Act of 1933, ch. 38, 48 Stat. 74 ("Sale" includes "every * * * disposition of * * * a security or interest in a security, for value"), with Section 1(3) of the Uniform Sale of Securities Act of 1929, reprinted in *Handbook and Proceedings, supra,* at 174 (Fourth and Final Draft) (1929) ("Sale" includes "every disposition * * * of a security or interest in a security for value"). Because Congress adopted the definitional language contained in the Uniform Act, and because that language embraced pledges, the term "sale" should extend to pledges in the present context. The Ninth Circuit's 1932 decision in *Woolery* authoritatively confirmed that the phraseology that Congress was soon to adopt included pledge transactions. The incorporated language should be given the same interpretation under the federal statute. See *Lorillard* v. *Pons,* 434 U.S. 575, 581 (1978): "where, as here, Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute." See also *SEC* v. *Cap-*

ital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963).[38]

D. Fraud in the Pledge of Securities to a Bank Lender is the Type of Behavior That Congress Meant to Prohibit Under the Securities Act of 1933

Since the language used by Congress in defining the term sale "is sufficiently clear in its context" and is "not at odds with the legislative history," it is unnecessary to consider contentions bearing on the general "purpose" and "policy" of the Securities Act of 1933. *Aaron* v. *SEC*, *supra*, slip op. 14–15; *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 214 n.33. Nonetheless, since petitioner bases his arguments in this Court in substantial part on what he terms "sound policy reasons" (Br. 20–26), we address these policy issues as well.

1. The Securities Act of 1933 was enacted by Congress in response to the stock market crash of 1929. *United States* v. *Naftalin*, *supra*, 441 U.S. at 775; *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 194–195. The purpose of the Act was to "help set the economy on the road to recovery" during the depression (*United States* v. *Naftalin*, *supra*, 441 U.S. at 775) by "protect[ing] the investing

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[38] We acknowledge that it may not always be appropriate to assume that Congress intended to ratify prior judicial decisions construing state statutes used as models for federal legislation. See *Aaron* v. *SEC*, *supra*, slip op. 19 n.18. In *Aaron*, however, this Court concluded that the "state judicial interpretation" was "at odds with the plain meaning of the language Congress enacted * * *." *Ibid.* In contrast, the Ninth Circuit's *Woolery* decision is completely consistent with the plain meaning of the Securities Act's sale definition and is supported by the traditionally recognized principles of commercial law discussed on pages 25–29, *supra*. Thus, Congress' definition of the word "sale" comes "'freighted with the meaning imparted to [it] * * * by contemporaneous discussion. In such conditions, history is a teacher that is not to be ignored.'" *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531, 545–546 (1978).

public and honest business * * *" (*ibid.*, quoting S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933)). Central to the economic difficulties that faced this nation following the market crash of 1929 was the failure of banks. Between 1921 and 1929, approximately 5,700 banks became insolvent, and the number of bank failures continued at an unprecedented pace during the depression.[39] For this reason, during the same year that Congress enacted the Securities Act of 1933, it also enacted the Banking Act of 1933, ch. 89, 48 Stat. 162 (the Glass-Steagall Act), which sought to prohibit federally insured banking institutions from engaging in certain securities activities deemed by Congress to be injurious. See *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629–634 (1971). Congress' concern for protection of the nation's banking institutions is also central to the federal securities laws. As Congress stated in Section 2 of the Securities Exchange Act of 1934, ch. 404, 48 Stat. 881, 15 U.S.C. 78b, federal "regulation and control" of securities transactions is essential "to protect and make more effective the national banking system and Federal Reserve System* * *." In particular, Congress declared that manipulation and control of securities prices is injurious to the national banking system because it tends to "prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System." *Ibid.*[40] This statement of regulatory purpose reflects Congress' awareness of the economic importance of the billions of

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[39] These bank failures are described in the legislative history of the Glass-Steagall Act, ch. 89, 48 Stat. 162. See S. Rep. No. 77, 73d Cong., 1st Sess. 8–10 (1933); 75 Cong. Rec. 9910 (1932) (remarks of Sen. Bulkley); see Lehr, *The Affiliation of Commercial Bank and Mutual Fund Personnel* (Pt.1), 83 Banking L.J. 377, 384 (1966).

[40] Petitioner's activities had precisely this effect. See pages 7–14, *supra*.

dollars of securities that are pledged as collateral with financial institutions in this country every year.[41]

Thus, it cannot seriously be contended that petitioner's fraud on Bankers Trust Company was beyond the concerns of the federal securities laws. To the contrary, petitioner's conduct is the very kind of conduct that Congress meant to prohibit when it outlawed fraud in every disposition of an interest in a security to protect investors, the general economy, and honest business. *United States* v. *Naftalin*, *supra*, 441 U.S. at 775–776.[42]

2. Petitioner nonetheless argues (Br. 20–23) that the Securities Act of 1933 is inapplicable here because the fraud that he practiced did not injure an "investor." That, however, is the same argument that this Court rejected in *United States* v. *Naftalin*, *supra*. In *Naftalin*, the defendant defrauded certain broker-dealers through a short selling scheme. The court of appeals held that the scheme was beyond the scope of the Securities Act because it had

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[41] The legislative history of this provision demonstrates Congress' concern over the impact of securities fraud on the operations of state and federal banks. See H.R. Rep. No. 1383, 73d Cong., 2d Sess. 4 (1934), noting that "[o]ver 13,000,000 men and women have savings accounts in mutual savings banks and at least 25,000,000 have deposits in national and State banks and trust companies—which are in turn large holders of corporate stocks and bonds." This Court has previously recognized that the antifraud provisions of the federal securities laws seek to protect creditors from fraud. See *Supt. of Insurance* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 12 n.8 (1971) ("Congress was especially concerned with the impact of frauds on creditors* * *").

[42] Rules of "lenity" and "strict construction" do not require a narrowing of the broad safeguards prescribed by Congress. See *United States* v. *Naftalin*, *supra*, 441 U.S. at 778–779; *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 354–355 (1943). Because the Securities Act of 1933 affords essential safeguards against fraud, it should be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes." *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 195; *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972); *Tcherepnin* v. *Knight*, *supra*, 389 U.S. at 336.

no impact on investors, and merely injured financial intermediaries.[43] This Court rejected that contention, holding that the Securities Act was intended to protect "honest corporate business" as well as "investors." 441 U.S. at 775–776. The lower court decisions that petitioner cites (Br. 14–20), which have concluded that a "pledge" is not covered by the federal securities laws, rely on the same erroneous view of legislative intent. Thus, in *Lincoln National Bank* v. *Herber*, 604 F.2d 1038, 1041 (7th Cir. 1979) (emphasis in original), the court incorrectly reasoned that the securities laws were enacted solely "to protect the *investor*."[44] And in *National Bank of Commerce of Dallas* v. *All American Assurance Co.*, 583 F.2d 1295, 1300 (5th Cir. 1978), the court of appeals erroneously assumed that the federal securities acts are only "designed to protect investors. This purpose is not affected by a pledge of stock." In sum, the premise on which petitioner rests his principal policy argument—that Section 17(a) of the Securities Act of 1933 is inapplicable to fraudulent practices unless an investor is injured—has been authoritatively rejected by this Court's decision in the *Naftalin* case.[45]

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[43] The fraud in *Naftalin* is similar to the fraud practiced by petitioner. In *Naftalin*, the defendant falsely represented to the financial intermediary that he was the "owner" of the securities that he purported to convey. The false representations in both cases occurred in the process of disposing or attempting to dispose of a security or an interest in a security, and had serious economic consequences for the business firms that were victimized.

[44] *Herber* applied this view of legislative intent instead of the plain meaning of the statute. The court recognized that the "sale" definition prescribed by Congress "would appear broad enough to embrace a transfer of a security interest in stock." 604 F.2d at 1040.

[45] The Second and Sixth Circuits have rejected petitioner's policy argument by holding that the antifraud provisions of the federal securities laws afford protection against fraud in the pledge of securities. *United States* v. *Gentile*, *supra*, 530 F.2d at 466–467 (Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a)); *Mallis* v. *FDIC*, 568 F.2d 824, 828–830 (2d Cir. 1977), cert. dismissed, 435 U.S. 381 (1978)

Moreover, as this Court emphasized in *Naftalin*, "the welfare of investors and financial intermediaries are inextricably linked—frauds perpetrated upon either business or investors can redound to the detriment of the other and to the economy as a whole." 441 U.S. at 776. Thus, while individual investors may suffer "no immediate financial injury" when a bank is defrauded in the pledge of securities (*ibid.*), such investors often prove to be the ultimate victims of fraudulent pledge transactions. If a pledgor fails to repay the loan, the pledgee, in reselling the collateral upon default, may serve as a conduit through which uninformed public investors who purchase the pledged securities are defrauded. Such investors often purchase counterfeit securities, worthless securities, or stolen securities that have been pledged through fraudulent schemes of the kind practiced by petitioner. See *Organized Crime—Stolen Securities: Hearings Before the Permanent Subcomm. on Investigations of the Senate Comm. on Government Operations*, 92d Cong., 1st Sess. 746–747 (1971); *Organized Crime—Securities: Thefts and Frauds: Hearings Before the Permanent Subcomm. on Investigations of the Senate Comm. on Government Operations*, 93d Cong., 1st Sess. 75–76 (1973).[46]

(per curiam), on remand, 615 F.2d 68, 74–75 (1980), petition for cert. pending, No. 79–1426 (filed Mar. 14, 1980) (Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b)); *Mansbach* v. *Prescott, Ball & Turben*, *supra*, 598 F.2d at 1027–1028 (Section 10(b) of the Securities Exchange Act of 1934). See also *Kerbs* v. *Fall River Industries, Inc.*, *supra*, 502 F.2d at 739.

[46] It is, of course, irrelevant that petitioner's fraudulent pledges took place in "face to face" transactions rather than "in the organized markets." *Supt. of Insurance* v. *Bankers Life & Cas. Co.*, *supra*, 404 U.S. at 12. It is also irrelevant that the immediate victim was a "sophisticated" bank (Bossier Amicus Br. 5). As the Fifth Circuit noted in *Lehigh Valley Trust Co.* v. *Central National Bank of Jacksonville*, 409 F.2d 989, 992 (5th Cir. 1969), "[f]raud may be * * * perpetrated upon the powerful and the sophisticated," as well as the "unsophisticated and the unwary * * *."

3. In a related argument (Br. 22), petitioner contends that the "risk" that the victim of his fraud assumed was commercial in nature, and that this should bar his prosecution under the Securities Act of 1933. However, there is nothing in the statute that suggests that the nature of the "risk" assumed by the victim of the fraud has any significance. Here, as in *United States* v. *Culbert*, *supra*, 435 U.S. at 380, the Court should decline petitioner's invitation to "limit the statute's scope" by reference to "undefined categor[ies]" such as commercial risk and investment risk.[47] Congress has drafted the statute unambiguously to apply to "every" disposition of an "interest" in a security for value. It makes no difference whether the disposition occurs in a "commercial" or "investment" setting. That is, the victim of the scheme may be either an "investor" or a "financial intermediary" as in *Naftalin*. If the definition prescribed by Congress is satisfied, the statute applies; "'[n]othing on the face of the statute suggests a congressional intent to limit its coverage'" to particular categories of arbitrarily defined risks. 441 U.S. at 774 n.5.[48] Thus,

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[47] Of course, the scheme in *United States* v. *Naftalin*, *supra*, which this Court determined was in violation of Section 17(a), did not involve a victim who assumed an "investment risk." Instead, the defrauded financial intermediary assumed a commercial risk inherent in delivering securities to other persons. See also *United States* v. *Brown*, 555 F.2d 336, 338–339 (2d Cir. 1977), cited with approval in *Naftalin* (441 U.S. at 775), where the defrauded victim assumed a commercial risk inherent in its role as a transfer agent, not an investment risk.

[48] An attempt to narrow the coverage of the Act's definition of "sale" by reference to undefined categories such as "commercial risk" and "investment risk" could lead to substantial ambiguities and arbitrary reductions in the protection that it affords. Various securities transactions entered into by financial institutions could arguably be characterized as "commercial" in nature. For example, a bank trust department may purchase equity securities for investment (generally in a privately negotiated transaction) under an agreement giving it the option to resell the securities to the seller at a later date. It could be argued that such a transaction is similar to an extension of credit se-

although petitioner urges the Court to look to "economic realities" (Br. 19), the "reality" of the transaction that he engaged in is a disposition of an interest in securities for value—precisely the kind of transaction that Congress meant to protect from fraud.

The commercial/investment dichotomy that petitioner would apply has been used by some lower courts in determining whether promissory notes or similar instruments are "securities" within the meaning of the federal securities laws. See, *e.g.*, *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1079–1080 (7th Cir.), cert. denied, 409 U.S. 1009 (1972). Here, however, there is no doubt that the instruments that petitioner pledged were securities, and the dichotomy that petitioner suggests is not useful in determining whether an "interest" in those securities was disposed of for value.[49]

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cured by stock, that the context is thus "commercial," and that the antifraud provisions of the federal securities laws therefore do not apply. Such an interpretation, however, would diminish the safety of the nation's financial institutions and conflict with the unambiguous prohibition of fraud in every disposition of a security or interest in a security for value.

[49] The reliance of petitioner and amicus on *International Brotherhood of Teamsters* v. *Daniel*, *supra*, and *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975), is entirely misplaced. In those cases, the Court applied the "economic realities" test in construing the definitions of the term "security" under the federal securities laws. In *Daniel*, the question before the Court was whether a participation in an involuntary noncontributory pension plan was an "investment contract" and therefore was within the definitions of "security" in the Securities Act of 1933 and the Securities Exchange Act of 1934. The Court applied the test prescribed in prior cases ("the 'touchstone' of the * * * test 'is the presence of an investment in a common enterprise premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others'") to answer that question (439 U.S. at 561). In *Forman*, the Court held that shares in a state-subsidized housing cooperative were neither "stock" nor "investment contracts" and thus were not "securities." In reaching its decision, the Court relied on legislative history indicating that Congress intended the definition of "security" to include the "many types of instruments that in our

Moreover, petitioner's suggested dichotomy between investors and pledgees, and the risks assumed by them, is an artificial one. As the Second Circuit pointed out in *United States* v. *Gentile*, *supra*, 530 F.2d at 467, a commercial bank that parts with substantial sums of money on the understanding that valuable securities are being conveyed to it to secure its claims assumes a risk like that of an investor:

> [T]he pledgee assumes a very real investment risk that the pledged securities will have continuing value, a risk that is identical in nature to the risk taken by investors which serves as the indisputable basis for statutory regulation of securities transactions.

In determining whether to approve a request for a secured loan, banks rely on the investment quality of the collateral (see pages 4–14, *supra*). When securities are pledged as collateral, the valuation process is much the same as if the creditor were purchasing them outright. Factors such as the grade, price, price stability, yield, degree of marketability, and diversification are all considered. The emphasis on value is further reflected in the common provision in secured loan agreements requiring that a minimum ratio of the current market value of the pledged securities to the amount of the outstanding loan be maintained. See generally, K. Lott and R. Myers, *Secured Lending*, *reprinted in* W. Baughn and C. Walker, *The Bankers Handbook* 641–643 (rev. ed. 1978).[50]

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commercial world fall within the ordinary concept of a security." 421 U.S. at 847–848, quoting H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933). The Court concluded that the purchase of "subsidized low-cost living space" (421 U.S. at 851) did not meet that test. In discussing the definition of "security," neither *Forman* nor *Daniel* shed light on the unrelated question of statutory interpretation presented here.

[50] Bankers accepting securities as collateral look to "credit quality, marketability and price volatility properties." Unlisted stocks and stocks that have a "limited market" are substantially less attractive to

While it is true, as petitioner contends (Br. 19), that banks obtain collateral on the understanding that it will be disposed of only in the event of a default, the prospect of a default is an ever-present danger that the collateral protects against. Where, as here, the bank is willing to part with its money only if the borrower assigns high quality and fully marketable securities, it is clear that a central element in the bank's decision to put its capital at risk, and an essential element of its bargain, is the "disposition" of an "interest" in the securities. As in the case of a purchaser in an ordinary securities transaction, the pledgee is vulnerable to fraud and stands to lose its assets if the securities prove worthless. Misrepresentations concerning the value of the securities deprive a pledgee, like any other purchaser, of its bargained-for valuable "interest" in the securities.[51]

4. Finally, petitioner contends that there is no need to provide a federal "remedy" in cases such as this because

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bankers than marketable securities issued by high quality companies. D. Hayes, *Bank Lending Policies* 164–167 (2d ed. 1977). See also H. Prochnow and R. Foulke, *Practical Bank Credit* 339 (2d ed. 1963), explaining that "a banker should generally obtain as collateral not only listed securities but also those in which trading is active. * * * [W]henever possible, the securities should represent well-established corporations, ably managed, and with a steady record of earnings." Accord, I M. Corns, *The Practical Operations and Management of a Bank* 449 (1962). See also American Bankers Association, Commercial Lending Division, *A Guide To Developing A Written Lending Policy* 17 (1977), noting that stock issued by a corporation "having no ready market value" is unacceptable as collateral. When reliable market values are not readily ascertainable, the bank accepting collateral should obtain "the latest financial statement of the corporation" to be "analyzed" so that "the book value [can be] obtained." M. Groves, *Loan Review: A Guide* 20–21 (1978). In sum, a bank parting with its money in reliance on collateral to secure its loan analyzes the securities that it receives in a manner similar to that of an ordinary conservative investor.

[51] It is ironic for petitioner to argue (Br. 19) that the bank's partial reliance on the assets and earning power of Tri-State as a source for

defrauded pledgees already have an adequate remedy "on a promissory note against the maker and any guarantor," that application of the federal securities laws is "unnecessary" because other federal antifraud statutes are applicable, and that fraudulent pledges are a matter of primary concern to the states rather than the federal government (Br. 10–11, 15, 25–26). There is no merit to any of these contentions.

a. At the outset, we emphasize that there is no question in this case of affording private remedies, express or implied. This case involves a criminal prosecution expressly authorized by Congress under 15 U.S.C. 77x. See *United States* v. *Naftalin*, *supra*, 441 U.S. at 774 n.6. This Court need not decide whether a violation of Section 17(a) of the Securities Act of 1933 gives rise to a private right of action in favor of any person. See *Aaron* v. *SEC*, *supra*, slip op. 8; *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 733–734 n.6. Nor should this Court decline to enforce the criminal penalties prescribed by Congress simply because, as petitioner asserts, a bank creditor has a civil contract remedy against its borrowers. In this case, that civil remedy was wholly non-existent because the collateral was virtually worthless, the borrower was insolvent, and petitioner (who had guaranteed repayment of the loan) filed a bankruptcy petition (see page 14, *supra*). Crimi-

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repayment of its loans should strip the bank of protection against fraud in the pledge of securities. Petitioner repeatedly deceived the bank into believing that Tri-State had substantial assets and earning power, and thereby diverted the bank from a careful check on the value of the collateral (see pages 3–6, *supra*). Of course, petitioner's fraudulent practices also prevented the bank from analyzing the value of the collateral when it sought to do so (see pages 9, 11, *supra*). Finally, petitioner's argument overlooks the fact that the very purpose of a security interest in marketable stock collateral is to enable the lender to obtain repayment of its loan in the event of default without having to look to the borrower's other assets. See *United States* v. *Gentile*, *supra*, 530 F.2d at 467.

nal sanctions are essential to deter other persons from engaging in such egregious fraudulent schemes.[52]

b. Application of Section 17(a) to petitioner's fraudulent scheme is unaffected by the fact that other federal criminal statutes also apply. Section 17(a) complements the protections afforded by other federal criminal statutes. As Senator Fletcher explained during the floor debates on the Securities Act of 1933 (77 Cong. Rec. 2983-2984 (1933)):

> Under the provisions of the bill we do not in anywise restrict or limit or weaken the laws already on the statute books. We are trying to cover instances where there seem to be loopholes and means of escape, and to apply the measure particularly to the matter of dealing in securities. * * * The bill rather strengthens and broadens the authority to proceed in such instances.

Moreover, as this Court repeatedly has recognized in securities fraud cases, statutory overlap with other antifraud provisions is neither unusual nor unfortunate. See *Edwards* v. *United States*, 312 U.S. 473, 484 (1941) ("[t]he two [antifraud statutes] can exist and be useful, side by side"); *United States* v. *Naftalin*, *supra*, 441 U.S. at 777-778 ("[the defendant] is undoubtedly correct that the two Acts prohibit some of the same conduct. * * * [But

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[52] Amicus Bossier Bank argues (Br. 5) that application of Section 17(a) to pledge transactions would require pledgors to furnish disclosure statements equivalent to registration statements. However, registration statements are required under the Securities Act of 1933 when securities are offered to the public by issuers, underwriters or control persons. They are not required in ordinary transactions in the aftermarket when unrestricted securities are traded or pledged by persons not affiliated with the issuer. See Section 4(1) of the Act, 15 U.S.C. 77d(1). Of course, the general antifraud provisions of the federal securities laws forbid deceptive statements and concealment of material information needed to avoid deception when securities are traded or pledged. These, however, are simply prohibitions of fraudulent conduct. We also note that a pledgor would be subject to criminal prosecution under Section 17(a) only if he engaged in deceptive practices "willfully." 15 U.S.C. 77x.

that] certainly does not absolve [him] of guilt for the transactions which violated the statute under which he was convicted."); *SEC* v. *National Securities, Inc.*, *supra*, 393 U.S. at 468 ("The fact that there may well be some overlap is neither unusual nor unfortunate."); see generally *United States* v. *Batchelder*, 442 U.S. 114, 123-124 (1979).[53]

c. Petitioner's contention that fraudulent pledges are of concern only to the states, and not the federal government, is refuted by the legislative history of the Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97. Prior to the enactment of that legislation, Congress held a series of hearings focusing on the involvement of organized crime in the securities field.[54] Those hearings

[53] Even though other federal antifraud statutes can often be relied on by the government in criminal cases, Section 17(a) serves an essential complementary purpose because it can be enforced by the Securities and Exchange Commission in civil injunctive proceedings brought to prevent injury caused by fraudulent pledge transactions. See *Aaron* v. *SEC*, *supra*. The SEC can sue in federal court to obtain injunctive and ancillary relief and can also institute disciplinary proceedings against securities industry professionals who violate Section 17(a). See, *e.g.*, Section 20(b) of the Securities Act of 1933, 15 U.S.C. 77t(b); Section 15 of the Securities Exchange Act of 1934, 15 U.S.C. 78*o*. In addition, other potentially applicable statutes prescribed by Congress have different coverages. For instance, 18 U.S.C. 1014, cited by petitioner (Br. 25), extends only to specified financial institutions and would not, standing by itself, prevent fraudulent pledges to other institutions such as insurance companies or brokerage houses.

[54] See *Organized Crime—Stolen Securities: Hearings Before the Permanent Subcomm. on Investigations of the Senate Comm. on Government Operations*, 92d Cong., 1st Sess. (1971) (hereinafter "*Hearings on Stolen Securities*"); Organized Crime—*Securities: Thefts and Frauds: Hearings Before the Permanent Subcomm. on Investigations of the Senate Comm. on Government Operations*, 93d Cong., 1st Sess. (1973) (hereinafter "*Hearings on Thefts and Frauds*"); Organized Crime—*Techniques for Converting Worthless Securities Into Cash: Hearings Before the House Select Comm. on Crime*, 92d Cong., 1st Sess. (1971) (hereinafter "*Hearings on Techniques for Converting Worthless Securities Into Cash*"); see also 121 Cong. Rec. 10733 (1975) (remarks of Sen. Jackson).

show beyond question that organized crime has disposed of massive quantities of stolen, counterfeit and worthless securities by fraudulently pledging them to banks as collateral for loans. Pledging securities as collateral for loans is a primary means by which worthless, counterfeit, and stolen securities are converted into cash, often for reinvestment into organized crime activities. The total value of lost and stolen securities was estimated to be as high as $50 billion.[55]

Far from being an issue of merely local significance, these congressional hearings reveal that organized crime engages in fraudulent pledge transactions on a nationwide basis, and often on an international basis. Federal law enforcement resources are essential in combatting securities fraud occurring on this scale. As Senator Jackson noted at the commencement of the *Hearings on Thefts and Frauds*, "stolen, counterfeit, and worthless securities" are used as "a basis for worldwide swindles cloaked in legitimacy, made even more dangerous by the extensive involvement of organized criminal groups." *Id.* at 1; see also *id.* at 2-5, 42-43, 124, 285, 479-482. He emphasized that "[t]his problem goes to the very foundation of our financial system." *Id.* at 2. The hearings focus repeatedly on the use of "phony loan schemes perpetrated via stolen and counterfeit securities * * *." *Id.* at 4; see *id.* at 75-76, 104, 130-131, 187, 316, 391, 406, 456, 518-519, 566 (pledge of stolen or counterfeit securities); see also *id.* at 263-264, 390, 454, 482 ("rental" of worthless securities to defraud bank lenders). In light of these revelations, Senator Jackson concluded that "[t]he situation is both serious and dangerous and strong Federal action is warranted," adding that "some observers feel that the integrity of the entire financial community is at stake." *Id.* at 480-481.

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[55] *Hearings on Thefts and Frauds, supra*, at 5, 20, 57.

The *Hearings on Stolen Securities* tell a similar story. As Senator McClellan pointed out (*id.* at 10):

> A variety of means are used to market stolen securities. The most common is the direct sale through brokerage houses and banks. However, a safer means from the viewpoint of the criminal is to pledge the securities as collateral for loans from banks and finance companies. Stolen securities can also be "rented" by a loan shark to a business man in need of loans. He, in turn, either pledges the securities as collateral for loans or adds them to otherwise legitimate balance sheets for the purpose of enhancing his credit rating.

These hearings are replete with descriptions of fraudulent pledges by organized crime of worthless, stolen and counterfeit securities as collateral for loans. *Id.* at 2, 9, 25, 39–41, 44, 48, 64, 73–75, 98, 283, 675, 676–678, 698, 745, 746–748, 847–856, 876, 894–897, 959–960, 1117–1118. Senator McClellan observed that "we have every reason to believe that the illicit traffic of negotiable securities is the latest and one of the most lucrative areas of concentration for most organized mobs in this country." *Id.* at 4. Corrective action in this field is the responsibility of both federal and local prosecutors, who have "concurrent jurisdiction," as the Attorney General explained. *Id.* at 27.

During the *Hearings on Techniques for Converting Worthless Securities Into Cash*, Congressman Pepper emphasized that local law enforcement efforts are insufficient to stop organized crime from defrauding financial institutions (*id.* at 1–2):

> Our investigation discloses that there is a national apparatus of individuals who are continually engaged in organized criminal conduct directly concerned with commercial transactions. * * * The essence of their activity is to give worthless securities, or commercial paper, a facade of value and respectability and then

> convert the worthless paper into hard cash. * * * These individuals move across state lines—from coast to coast and internationally—bankrupting small banks, insurance companies, and stock brokerage institutions. Local law enforcement is entirely inadequate to cope with a scheme which is planned in California, prepared in New Jersey, and executed in Ohio.

Congressman Pepper also noted (*id.* at 3):

> A * * * device currently used by sophisticated organized criminal elements is the bank loan which is secured by worthless securities. Our investigation demonstrated that numerous banks throughout the country were defrauded when they issued loans which were secured by worthless * * * notes. One bank in Ohio was nearly bankrupted when it suffered losses of over $1 million.

See *id.* at 242, 259, 268, 306, 308, 361, for a description of the techniques organized crime employs in obtaining bank loans through fraudulent pledges.[56] At the conclusion of these hearings, Congressman Pepper admonished that organized crime had defrauded banks and other financial institutions of "millions of dollars annually" and that "more aggressive procedures on the part of governmental entities which are responsible are absolutely necessary." *Id.* at 361.[57]

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[56] The extensive involvement of organized crime in fraudulent pledge transactions is also recounted in Note, *Insecure Securities: Thefts of Stocks and Bonds*, 6 Colum. J. L. & Soc. Prob. 478, 483-484 (1970); Koblenz, Weglian, Kieszkiel, and Dawson, *Let's Blow the Whistle on the Securities Game*, 60 A.B.A. J. 461-463 (1974).

[57] The facts disclosed in the foregoing hearings prompted Congress to add Section 17(f)(1), 15 U.S.C. 78q(f)(1), to the Securities Exchange Act of 1934 in 1975. See 89 Stat. 137. Under that provision, federally insured banks, among others, are required to report information about missing, counterfeit and stolen securities to the Securities and Exchange Commission pursuant to Commission rules. Under this statutory authority, the Commission has established a lost and stolen secu-

In sum, there is no merit to petitioner's assertion that fraudulent pledges are a matter of merely local concern. The legislative history of the Securities Acts Amendments of 1975 shows beyond genuine doubt that fraudulent pledges pose a serious threat to both the nation's financial institutions and financial markets, national assets that it was the purpose of the federal securities laws to preserve.[58]

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rities program that includes bank pledgees. See 17 C.F.R. 240.17f-1. As of December 1979, the Commission had compiled a computerized data base covering over $2 billion in lost, counterfeit, and stolen securities. See SEC Staff Report, *Lost and Stolen Securities Program, 1979 Statistics*. Congress' enactment of Section 17(f)(1) is but a further reflection of its determination that federal action is essential to prevent fraud in the pledge of securities.

[58] Petitioner cites Professor Loss' treatise (I *Securities Regulation* 649 (2d ed. 1961)) for the proposition that enactment of the Securities Act of 1933 was not "needed" to reach fraudulent pledges. Petitioner fails to note that Professor Loss explicitly recognizes that "[i]t is probably easier under the language of § 2(3)—'every * * * disposition of a security, or interest in a security, for value'—to say that a pledge involves a 'sale' than that it does not. Hence every pledgee may be considered to be a person who 'purchases' within the meaning of § 2(11)." Professor Loss explains that this analysis is relevant in deciding whether "a fraudulent pledgor violates § 17(a)." *Ibid.* Professor Loss' remark in 1961 on the "necessity" of enacting federal legislation in this field was a preface to his discussion of the question, not involved in this case, whether a pledgee who receives securities from an issuer, underwriter, or control person is required to obtain a registration of the securities before selling them to the public. See also Sargent, *Pledges and Foreclosure Rights Under the Securities Act of 1933*, 45 Va. L. Rev. 885, 893-894 (1959).

Professor Loss is currently the reporter for the proposed *Federal Securities Code* (Proposed Official Draft 1980). The Code, which has been approved by the American Bar Association and the American Law Institute, expressly "define[s] a pledge as a sale for purposes of the fraud part." ALI *Federal Securities Code*, Comment (6) to § 202(143), at 190 (1980); see *id.* at § 202(143)(F) ("The terms [sale, sell, offer and offer to sell] * * * include * * * for purposes of part XVI ["fraud, misrepresentation, and manipulation"], a hypothecation or security loan").

CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted.

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